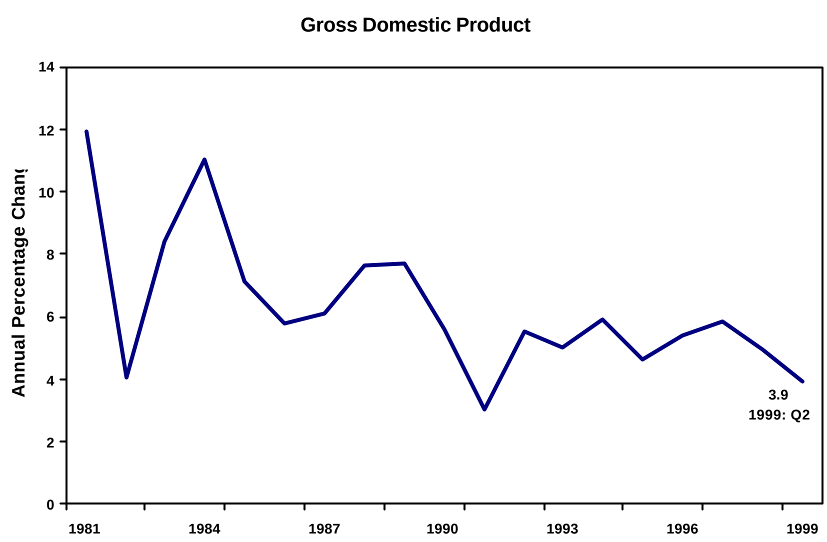
US Economic Prosperity:
Non-Inflationary Growth, Low Unemployment and Rising Income

RECENT DEVELOPMENTS IN THE US ECONOMY

For the first time in over a generation, most Americans are enjoying economic prosperity. Unemployment is down, inflation is low and incomes are rising. Much of this improvement in the economy can be traced to eliminating the federal budget deficit and increasing productivity-enhancing investment.

The US economy is currently in its ninth consecutive year of economic growth, the nation's longest peace-time expansion.

The economy has grown on average by more than 3 percent a year since 1991. There are virtually no signs of any economic slowdown on the horizon, as real GDP growth during the second quarter of 1999 was nearly 4 percent. Nine years of sustained growth has made the US economy the envy of the world.

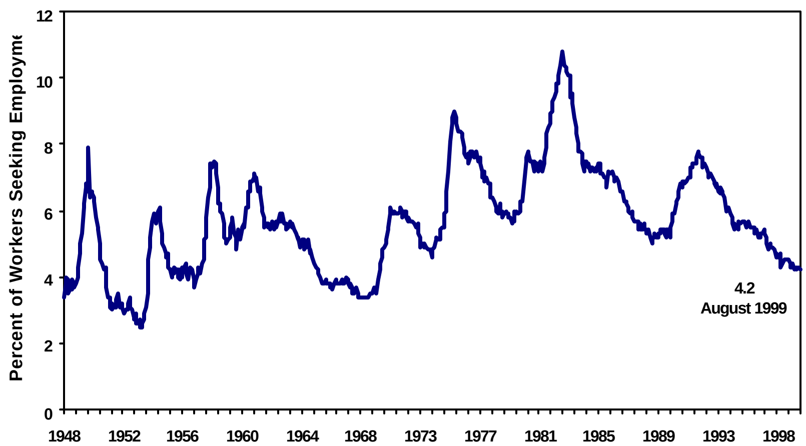


Unemployment is at its lowest rate since the early 1970s.

The unemployment rate has been at or below 5 percent during each month since April 1997. During the first half of 1999, the unemployment rate averaged 4.3 percent, the lowest rate in more than 25 years. The unemployment rate in the United States is currently lower than that in Japan and many European countries.

Almost all groups within the economy have been enjoying improvements in unemployment. At 1.6 percent, the unemployment rate for college graduates in August 1999 remains the lowest of all

Unemployment Rate



Source: Bureau of Labor Statistics

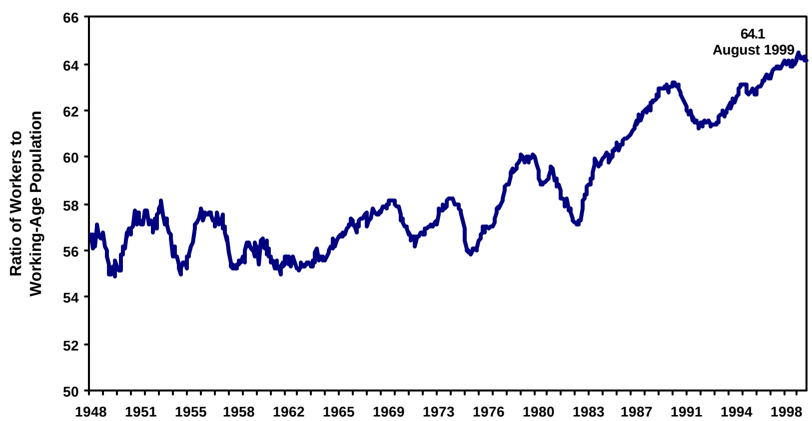
groups. By contrast, the unemployment rate for high school graduates who do not go on to college is more than twice the college rate, at slightly below 3.5 percent.

Minorities and teenagers have achieved the greatest improvements in unemployment rates. The unemployment rate for all minorities fell from 12.7 percent in 1992 to 6.8 percent in August 1999. Over the same period, the unemployment rate for African-Americans fell from 14.2 percent in 1992 to 7.8 percent in August 1999. The teenage unemployment rate fell from 20.1 percent in 1992 to 13.5 percent in August 1999. Although teenage and minority unemployment rates remain well above the national average, they have fallen to their lowest levels since the government began reporting such rates. In general, minority and teenage unemployment rates tend to be slower in responding to economic expansions, making improvements in these unemployment rates harder to achieve. Most of the improvements in these unemployment rates have occurred over the last four years.

More Americans are currently working than ever before.

More than 64 percent of the working-age population are currently employed. This constitutes the highest ratio of workers to the

Worker to Population Ratio

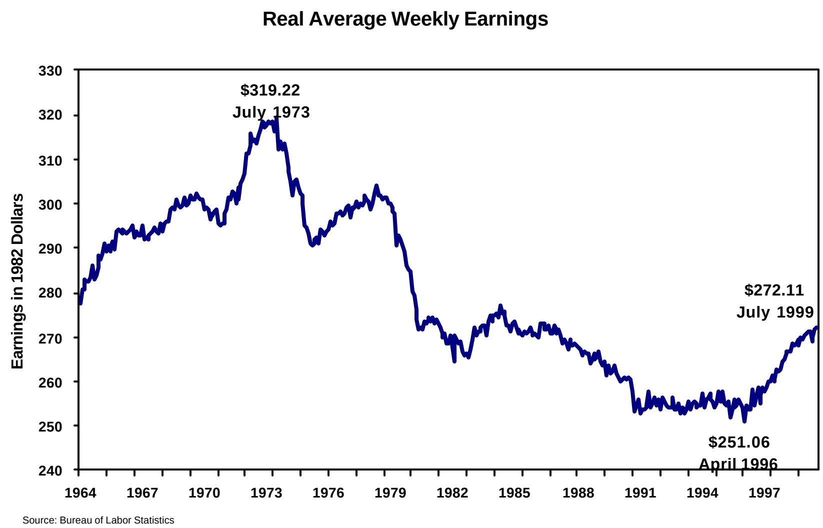


Note: Beginning in 1990, data reflect 1990 census-based population controls, adjusted for the estimated undercount.
Source: Bureau of Labor Statistics, Current Population Survey

total working-age population in recent history. The employment-population ratio for African-Americans and Hispanics were 60.3 percent and 63.3 percent, respectively, in August 1999, not much different from the national average.

After 20 years of stagnation, real average weekly earnings are rising.

Real average weekly earnings were either falling or flat for



most of the last 20 years. Weekly earnings did not begin increasing until well into the current economic recovery. Since 1996, real average weekly earnings have increased by 6 percent. Despite this recent increase, the *level* of real weekly earnings remains below its pre-1980 level.

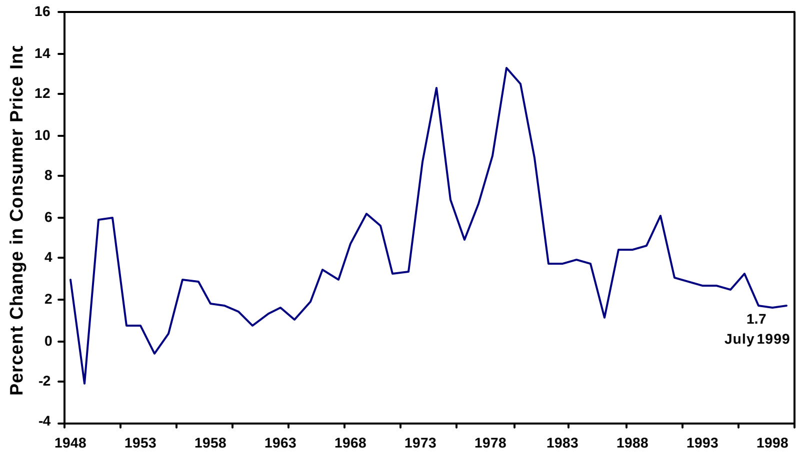
The recent improvement in wages has not appeared to have placed upward pressure on inflation. Growing competition — originating both at home and abroad — lower producer costs and improvements in productivity continue to restrain increases in consumer prices.

Inflation has fallen to its lowest rate in almost 30 years — despite continued declines in the unemployment rate.

During the first half of 1999, inflation rose by an annual rate of 2.2 percent. Falling commodity prices, significant reductions in transactions costs and moderate business expenses have contributed to keeping prices low. At a recent hearing before the Joint Economic

Committee, Federal Reserve Chairman stated that the economy had reached "price stability." This stability makes it easier for businesses and consumers to plan ahead.

Inflation Rate



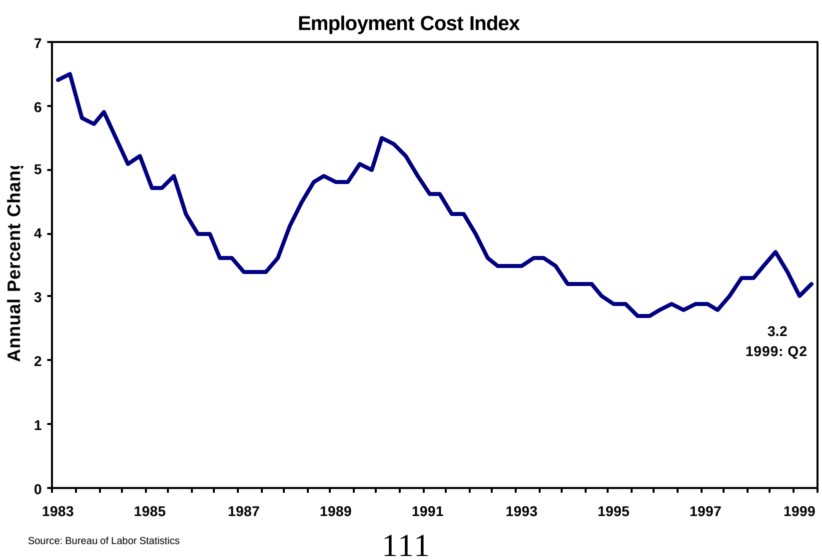
Source: Bureau of Labor Statistics

Employment costs remain low.

The Employment Cost Index (ECI), which measures the costs to employers of hiring workers, remains low. The ECI includes both the cost of wages and benefits. Low employment costs have bolstered corporate profits during the 1990s, which, in turn, have helped fuel the recent stock market surge. Corporate profits have also enabled companies to expand payrolls — by hiring more people and paying them more — and increase their investments.

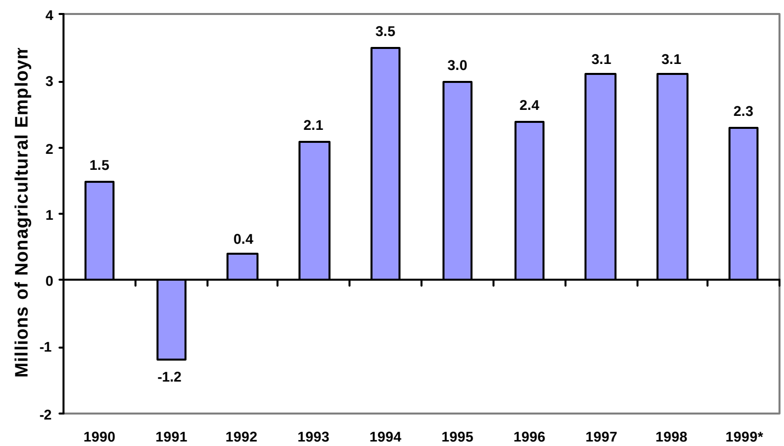
Employment continues to grow.

Nonagricultural employment grew by more than 20 million between 1992 and August 1999, adding, on average, approximately 2.8 million jobs annually and 230,000 jobs per month. These data reflect *net* increases in employment, representing the change in total employment, not the gross number of new jobs created or eliminated. The distribution of the close to 20 million net new jobs created since 1992 is as follows:



10.1 million	in traditional services
4.6 million	in wholesale and retail trade
2.1 million	in transportation and finance
1.6 million	in government (despite no increase in federal government employment)
18.4 million	in all services (91 percent of the more

Annual Growth in US Employment

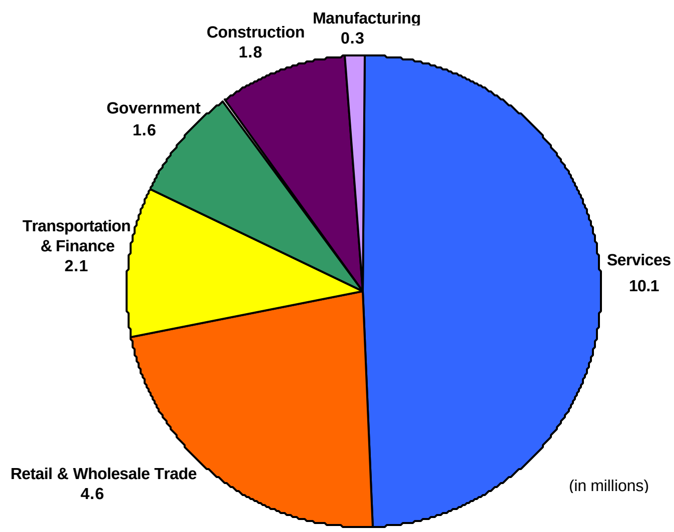


*First six months of 1999.
Source: Bureau of Labor Statistics

	than 20 million jobs created)
1.8 million	in construction
280,000	in manufacturing. Manufacturing employment increased by 748,000 jobs between 1992 and May 1998.

Nearly a half million jobs have been lost since then, primarily due to the East Asian financial crisis.

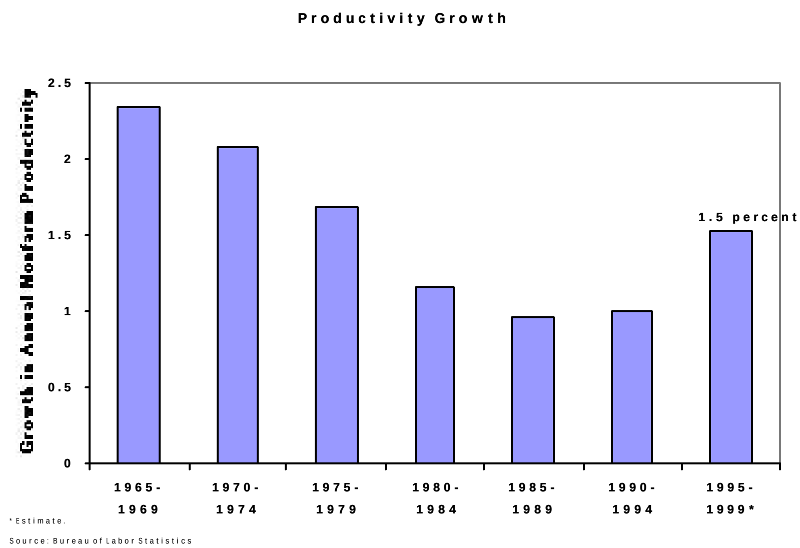
Recent improvements in productivity have enabled wages and incomes to grow.



Approximately 20 million net new jobs were created between 1992 and August 1999.

Source: Bureau of Labor Statistics

Productivity growth is the key to achieving sustainable improvements in living standards. Productivity growth reflects real improvements in the efficiency of workers and the equipment they use. These efficiency improvements must be perceived to be long-term in order to result in sustainable increases in salaries and incomes. If incomes rise faster than productivity (which was the case for much of the 1970s), inflation can result. If productivity grows faster than incomes (which was the case during much of the 1980s and early 1990s), then workers will experience real declines in their living standards.

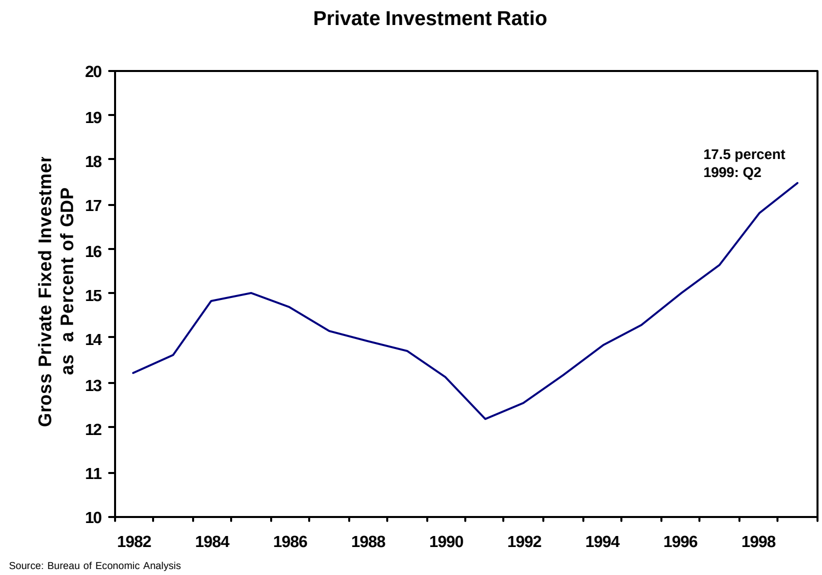


Productivity in the nonfarm business sector grew by more than 2 percent per year between 1995 and the first quarter of 1999. This represents a doubling of the productivity growth rates experienced during the 1980s. This increase in efficiency of workers and the equipment with which they work is one of the greatest achievements of the current economic expansion.

The key ingredient to improving productivity is increases in productive investments.

Total private investment as a share of GDP fell from 15 percent in the mid 1980s to close to 12 percent in 1991. The investment rate began growing in 1992, and reached more than 17 percent during the second quarter of 1999. This investment in plant, equipment, research and development is critical to raising productivity, which in turn enables companies to increase wages and salaries without fear of reigniting inflation. These investments continue to have positive impacts on productivity well into the future.

Recent investments in information technology and human capital — through education and training — have been key factors in raising US productivity over the last few years. In addition, productivity gains have also resulted from structural changes in the labor market over the last 20 years. Faster productivity growth can be



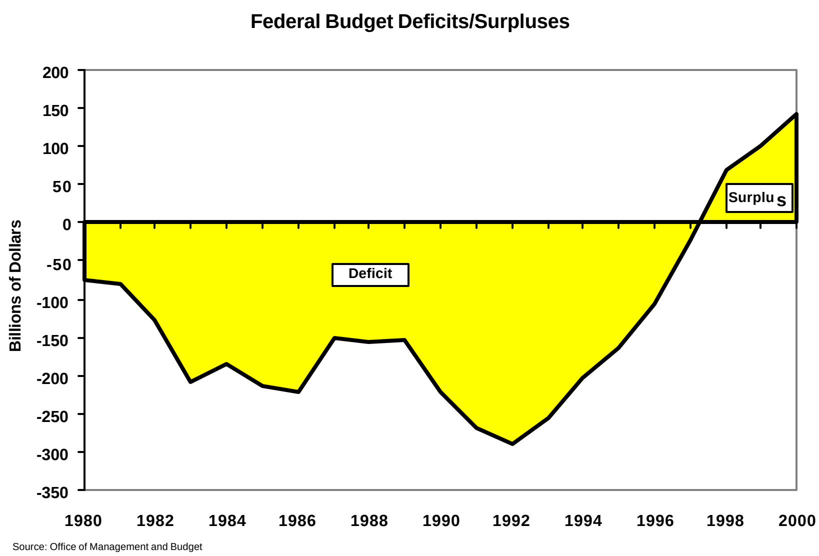
seen in quicker inventory turnover, a greater use of worker skills and higher quality controls.

In order to achieve a higher return, it is optimal to finance domestic investment through domestic saving. There are two major components of domestic saving — personal saving and government surpluses. Since 1992, there has been a significant improvement in public saving — by eliminating the federal budget deficit — and a deterioration in personal saving.

The federal budget has moved from a deficit, which was close to 5 percent of GDP in 1992, to its current surplus of approximately 1 percent of GDP. Based on current economic assumptions, the surplus is expected to continue growing.

A combination of an increase in tax receipts — due in part to the strong economy and some changes in tax policies — and severe constraints on total federal spending have resulted in bringing the federal budget from deficit into surplus.

The Office of Management and Budget (OMB) recently projected that the federal budget surplus is expected to grow over the next decade. In addition, OMB and the Congressional Budget Office (CBO) recently revised their surplus projections, based on more optimistic economic assumptions. The most important change is an increase in projected productivity growth over the next several years.



Raising the estimates for productivity growth between 1999 and 2002 from 1.3 percent to 1.6 percent, results in increasing projected economic growth from 2.2 percent to 2.5 percent annually. Stronger growth, in turn, stimulates higher tax receipts and puts less pressure on federal spending, thereby raising the projections for surpluses during this period.

These revised surplus projections may be based on several unrealistic assumptions, including real cuts in federal spending over the next several years. These spending levels also exclude any emergency spending, e.g. disaster relief and military initiatives, as well as any future increases in defense spending. In addition, some proposals assume that some of the budget surplus will be used to reduce the public debt, thereby reducing federal interest payments on that debt.

Much of the credit for the current economic expansion can be traced back to the elimination of the budget deficit, thereby enabling monetary policy to be more flexible.

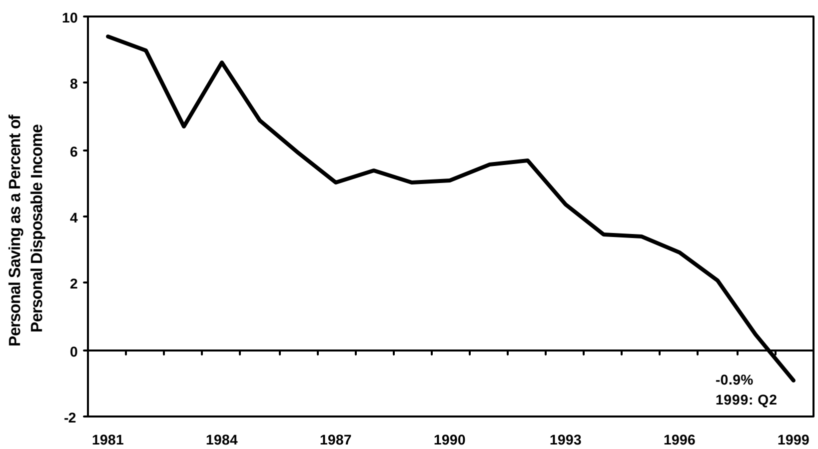
Improvements in government saving seem to have been offset by further reductions in private saving.

Americans have traditionally saved less than others around the world. The US personal saving rate has been falling since the early 1980s. In addition, by 1998, the personal saving rate turned negative. Since personal saving is the residual of personal disposable income minus personal consumption during any particular time period, a negative saving rate suggests that Americans, on average, are consuming more than they earn.

The saving rate is a little misleading, as it does not take into account the accumulation of wealth. For example, many Americans put their saving into their homes, and home-ownership is very high in the United States. The asset value of housing is not included as saving. Likewise, other investments, such as stocks and bonds, and the accumulated returns on these investments, are also not included as saving.

Regardless of these problems in defining saving, it is still important to note the precipitous decline in the saving rate over the last 20 years. Part of this decline may be explained by increased

Personal Savings Rate



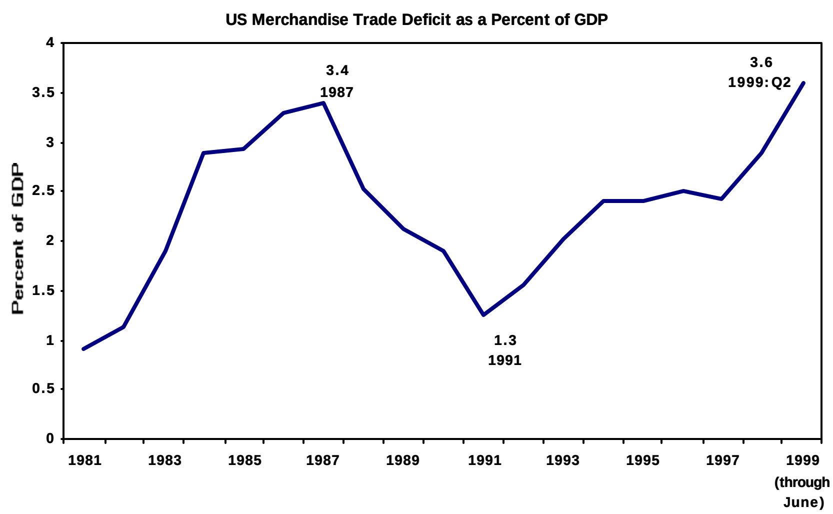
Source: Bureau of Labor Statistics

investment in assets currently not included in the definition of saving. Another factor may be the consequence of the significant shift in the federal budget from deficit to surplus over the same period. This improvement in government saving may have resulted in shifting more financial burdens on to individuals, either by paying more for services previously provided by the government, or by paying higher taxes.

The improvement in public saving — the move from budget deficit into surplus — has been more than offset by the decline in personal saving. Together, domestic saving has been inadequate to finance the strong growth in domestic investment, making it necessary for the United States to continue borrowing from abroad.

One consequence of this increasing gap in saving and investment has been the widening gap in the US current account. The single largest component of the current account deficit has been the growing merchandise trade deficit.

A combination of factors, including the East Asian financial crisis, slow growth in the industrialized countries and the strength of the US dollar, have contributed to widen the merchandise trade deficit. The merchandise trade deficit in 1998 was close to $250 billion. Initial monthly reports suggest that the deficit can be expected to reach $300 billion in 1999. In terms of percent of GDP, the trade deficit is currently as large as it was in 1987, prior to the Plaza Accord, which resulted in significant changes in exchange rates.



Source: Economic Report of the President

The growing trade deficit helps explain some of the job losses in the manufacturing sector discussed above. On the other hand, the trade deficit may be currently serving as a “safety valve,” preventing the economy from over-heating and holding down inflation due to falling import prices.

Recent economic developments abroad have contributed to the current economic expansion in the United States. Increased competition at home and abroad has tended to place downward pressure on prices. Currently, US firms are reluctant to raise prices for fear of losing markets to other competitors. This has enabled falling world oil and other commodity prices to be passed on to consumers.

US economic growth has been outpacing the growth experienced in most other major industrialized economies. This is due to the strength in the US economy and continued weaknesses in the rest of the world, particularly in East Asian and Europe. On the other hand, slow growth abroad has depressed many of US industry’s traditional export markets. Weakened currencies abroad have boosted US imports while making US exports more expensive. As a result, the US merchandise trade deficit has increased, reflecting a significant increase in imports and a decline in exports. This development has placed considerable pressure on the US tradeable goods sector and its workers.

Overall, there is much to celebrate in the current economic expansion. At the same time, not everyone in America has enjoyed the benefits of growing economy.

The economy seems to be split into two groups — those who are able to share in the fruits of economy-wide growth, and those for whom it takes longer to personally realize some of the broader national economic gains. Economic statistics based on national averages tend to camouflage the plight of this second group.

For example, per capita income growth across the nation averaged 4.5 percent annually between 1991 and 1997. Despite this strong growth, approximately 500 counties — almost 16 percent of all counties — experienced no growth in average annual per capita income. By contrast, the remaining 2580 counties experienced an average per capita income growth of 5½ percent annually during the same period. The low per capita income growth ("low growth ") counties constituted more than 24 million people, or roughly 10 percent of the nation's total population. These countries tended to have a heavier reliance on farming and mining than the other countries. Despite the recent pick-up in the California economy, 29 percent of all Western counties experienced almost no per capita income growth.

As might be expected, the low growth counties had a higher incidence of poverty, with almost 700,000 families in these counties facing poverty in 1997. The low growth counties also had lower high school and college graduation rates than the higher per capita income growth counties. The low growth counties included large population centers such as Los Angeles, Fresno, Santa Barbara, Queens and Honolulu.

In addition to per capita income growth, there are regional differences in unemployment rates. In 1998, 389 counties — 13 percent of all counties — experienced unemployment rates at or above 8 percent, close to twice the national average. A little more than half of those counties — 187 of them — experienced unemployment at or above 10 percent. Less than one third of the counties which experienced low per capita income growth also had high unemployment rates.

The high unemployment counties constituted 20 million people — 7 percent of the national workforce. A sizable number, but not all of high unemployment counties were major population centers. These included two of the five New York boroughs. These counties were not regionally concentrated: 39 states had at least one high unemployment county. Yet some states do have a disproportionate number of high unemployment counties. In 11 states, more than 10 percent of the state's workforce was found in high unemployment counties. The high unemployment counties tended to correlate with lower educational achievement and a persistence of high unemployment. (See attached paper, "Pockets of High Unemployment in a Low Unemployment Economy.")

In addition to a regional gap in per capita income and unemployment, there has also been a widening gap between income groups. Between 1989 to 1996, income growth was concentrated in those families whose earnings were in the top 20 percent of the income distribution. The remaining families experienced either no improvement or actual declines in their income. The widening income gap has resulted from income gains at the high end of the distribution and income stagnation or losses for the vast majority of the others.

One of the factors behind the declines in living standards for those on the lower end of the income distribution has been the erosion, and in some cases even elimination, of several government programs. Examples include welfare reform and the erosion in the real value of the minimum wage.

THE MINIMUM WAGE

During the past two decades, the ***real*** value of the minimum wage has been falling. This has hampered the ability of those at the lower end of the socioeconomic scale to fully share in the benefits of the recent economic prosperity. This erosion continues despite moderate increases in other wage and salary indices.

Part of the continuous erosion in the minimum wage can be explained by its legislatively-mandated structure. The minimum wage can only be adjusted by an act of Congress. Thus, the minimum wage, by its very nature, is reactive and is always trying to "catch up" to changes in prices and other wages.

The minimum wage was first instituted in 1938 to help ensure "maintenance of the minimum standard of living necessary for health, efficiency, and general well-being of workers." The minimum wage is one of the country's oldest income policy tools.

It covers employees of enterprises doing at least $500,000 in business annually, as well as employees of smaller firms engaged in interstate commerce, government workers, hospital workers, school employees, and many domestic workers. In 1998, 4.4 million people earned the minimum wage, which is currently set at $5.15.

Distribution of Minimum Wage Workers by Industry 1998		
Industry	Number of Minimum Wage Workers	Percent of all Minimum Wage Workers
Retail Trade	2,334,000	52.7
Services	1,100,000	24.8
Manufacturing	299,000	6.8
Government	285,000	6.4

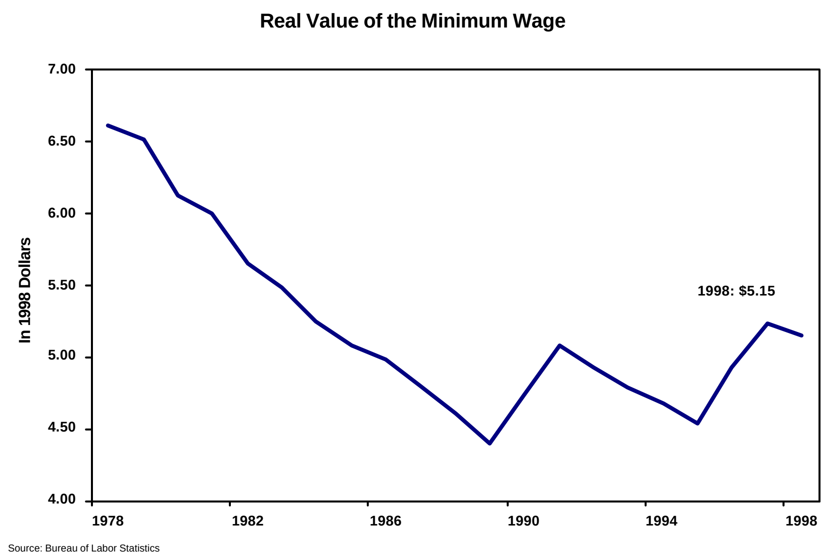
Most employees receiving the minimum wage work in fast food restaurants, retail establishments, and low-end service jobs (such as commercial housekeeping). More than half of those workers earning the minimum wage are employed in retail trade. Another 25 percent of minimum wage workers are employed in agriculture and 6 percent of those workers are employed in the public sector.

The typical minimum wage worker is an adult woman, and likely a minority. In 1998, women comprised almost two-thirds of minimum wage workers, and seventy percent of minimum wage earners were 18 years of age or older. A larger percentage of minorities earn the minimum wage, by age group, than white workers.

The most recent increase in the Federal minimum wage occurred in two steps in 1996 and 1997. On October 1, 1996 the minimum wage was increased from $4.25 to $4.75, followed eleven months later, on September 1, 1997, by an increase to $5.15. In 1996, Congress instituted a separate, lower ($4.25) sub-minimum wage for young workers, who are less than 20 years old during their first 90 days of employment with a particular employer.

After increases in the 1950s and early 1960s, the real value of the minimum wage peaked in 1968, fluctuated during the 1970s, and has, for the most part, been declining since then. The current minimum wage, $5.15, is similar to its real value in 1983 and 1984, and remains *below* its real value during the 1960s and 1970s. Over the last 20 years, the real value of the minimum wage has fallen by 22 percent. By contrast, the real average wage for all hourly workers has declined by 10 percent, or less than half that amount. Workers earning the minimum wage have been experiencing a real decline in their living standards — earning less and less for the same amount of work, and falling farther and farther behind.

The minimum wage has weakened relative to average wages in manufacturing and other private industries. At its peak in 1968, the minimum wage was about half of the average wage in manufacturing. Improvements in manufacturing wages and the continued erosion in the minimum wage through the 1990s, has resulted in the minimum wage standing currently at only approximately one-third of the average manufacturing wage.


Real Value of the Minimum Wage
In 1998 Dollars
7.00
6.50
6.00
5.50
5.00
4.50
4.00
1978
1982
1986
1990
1994
1998
1998: $5.15
Source: Bureau of Labor Statistics

The minimum wage does *not* guarantee a family income above the poverty level. Working full-time at the minimum wage, an individual would earn a gross salary of $10,300, without taxes and benefits. After taking taxes into account — subtracting the payroll tax and adding back the Earned Income Tax Credit — net income would be $10,912. This is lower than the national poverty rate for a family of one adult and one child ($11,235), one adult, two children ($13,133) and two adults, one child ($13,120). In order for an adult working full-time to earn enough to meet the federal poverty guideline for a family of two, the minimum wage would need to be set at $5.62. For a single parent with two children, the minimum wage would need to be at least $6.57.

Many states and localities have recognized that the federal minimum wage is not adequate and have instituted higher minimum wages for some or all workers. These initiatives fall into two categories, based upon whether the public body is a state or local government (county or municipality). State laws can mandate a minimum wage that is higher than the federal level, but not lower. Nine states — Alaska, California, Connecticut, Delaware, Hawaii, Massachusetts, Oregon, Washington and Vermont — and the District of Columbia have minimum wages which are higher than the federal minimum wage. These range from $5.25 in Hawaii, Massachusetts and Vermont to $6.50 in Oregon. These nine states and the District of Columbia cover one-fifth of the working-age population.

In addition, over 30 cities and counties have adopted ordinances which require those companies awarded municipal contracts, their subcontractors, and/or those receiving economic development funds to pay their employees a "living wage" set above the federal minimum. Many living wage ordinances are based upon poverty rates, adjusted for local living expenses for a family of two, three, or four, and are frequently indexed. In addition, many localities have begun adding a health care coverage component, by which firms not providing health coverage must pay their employees an additional amount. Many of the existing programs require an additional $1.00 an hour in wages be paid to those workers not covered by health insurance.

The 1996 and 1997 increases in the minimum wage have been accompanied by falling unemployment rates for teenagers and minorities, those groups most likely affected by the minimum wage. Between 1996 and the first half of 1999, the unemployment rate for teenagers fell from 16.7 to 13.5 percent, the Africa-American unemployment rate has fell from 10.5 to 7.3 percent and the unemployment rate for other minorities fell from 8.9 to 6.8 percent. Similar patterns have also occurred in states which have recently raised their minimum wage above the federal level. With respect to living wage ordinances, 2 years following the establishment of a living wage in Baltimore, the costs of city contracts declined, wages increased, and unemployment declined.

Recent evidence flies in the face of the claims that increases in the minimum wage necessarily lead to increased unemployment. Three issues must be considered when estimating the impact of an increase in the minimum wage on employment: the prevailing minimum wage, the size of the increase and the economic environment against which the increase is taking place. As the US economy enters one of it longest expansions in recent history, there are signs of labor shortages in many parts of the country. Raising the minimum wage during a period of a tight labor market may result in more employment. In addition, firms may be more willing to train those workers employed at the minimum wage, thereby increasing productivity. In addition, as people are being moved off the welfare rolls and brought into the workforce, and other benefits are being reduced, it is becoming increasingly important that full-time employment brings enough earnings to purchase basic food, shelter, and health care.

PRESCRIPTION DRUG BENEFIT

Concerns about rising prescription drug costs, the desire to enable more seniors to take advantage of new effective medications, and arguments that proper use of medications can decrease the reliance on other, more expensive treatments have led to various initiatives to incorporate a prescription benefit into the Medicare program. As part of its plan to reform and expand Medicare, the

Administration has included a significant prescription drug benefit, similar to HR 1495, Access to Prescription Medications in Medicare Act of 1999, proposed by the Committee's Ranking Member, Congressman Pete Stark, in late 1998.

Since 1980, drug expenditures have grown in the double digits, far more than the growth in total health care expenditures. In 1997 alone, drug expenditures grew by 14 percent, almost three times the growth rate of total national health care expenditures, hospital service expenditures and physician service expenditures.[1] Most of the growth in drug expenditures can be traced to a significant increase in volume, mix and availability. As the costs of prescriptions escalated and an expanded number of new medicines provided cost-effective alternatives to other medical therapies, private drug plans began covering an increasing portion of all prescription drug payments during the 1990s.

Yet those who rely the most on prescription drugs — the elderly — do not have any comprehensive prescription drug coverage, as a group. Although they comprise only 12 percent of the population, the elderly account for a third of all prescription drug use.[2] However, almost 14 million elderly — approximately one-third of the 38 million people enrolled in Medicare in 1997 — had *no* prescription drug coverage at all. An additional 4 million people voluntarily paid more and received limited prescription coverage. The rest were covered either through Medicaid or private employer-based plans.

Prescription drug costs have become a significant financial burden on the elderly, as drugs are the single largest out-of-pocket medical expense for seniors, many of whom have moderate incomes. In 1994 and 1995, 76 percent of the seniors had incomes below $30,000 and the average senior paid $558 for prescriptions. This compared to an average of $355 spent by 55 to 64 year-olds during the same period. In fact, a 1993 survey found that one in eight seniors reported having to

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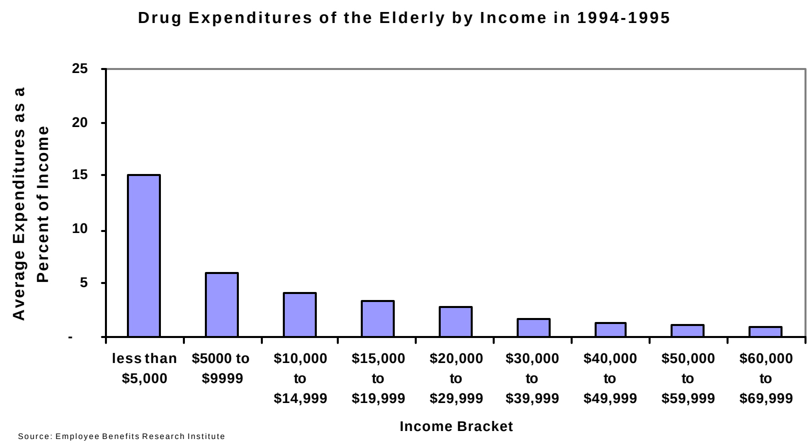
1 Employee Benefits Research Institute, Issue Brief 208, April 1999.

2 *Ibid*.

chose between medicine and food at some point during the year.[3]

[3] *American Pharmacy,* October, 1992; HCFA Office of Strategic Planning, Data from the Current Beneficiary Survey, cited in staff documents, Medicare Commission; Department of Health and Human Services, unpublished data; Committee on Government Reform and Oversight, US House of Representatives, Minority Staff Report, "Prescription Drug Pricing in the United States: Drug Companies Profit at the Expense of Older Americans," October 20, 1998.

Additionally, private sector benefit managers are able to negotiate lower drug prices than uninsured individuals. Consequently, Medicare beneficiaries without supplemental private insurance for prescription drugs spend twice as much on prescription drugs as their counterparts with private insurance.[4]



To address this deficit in health care coverage, the Administration's prescription drug benefit would:

- Be a voluntary plan, available for purchase by all Medicare beneficiaries, generally, on a one-time only basis;
- Have no deductible, so that all enrollees would begin benefitting from the plan with the first prescription filled;
- Be phased-in from 2002 to 2008;
- Have a subsidized premium, estimated at $24 a month in 2002 and $44 per month when fully phased-in by

4 Rogowski, *The Gerontologist* 37:4 (August 1997).

2008;

- Pay for half of the prescription costs up to a total of $5,000 total drug costs ($2,500 in Medicare payment) by 2008; and
- Be subsidized for beneficiaries with incomes below 135 percent of poverty (those individuals earning below $11,000 and couples earning below $17,000 would pay no premium or co-payments). Those people living 35 to 50 percent above the poverty rate would pay only partial premiums.

Several cost saving mechanisms would be incorporated, as well as incentives to employers, to maintain and develop retiree health coverage which include a prescription drug benefit package similar to (or better than) to the Administration's proposal. The Administration estimates that its plan would cover roughly 31 million older and disabled citizens each year. It also estimates that the plan will cost $118 billion over the next 10 years, mostly to be paid by cost savings instituted elsewhere within Medicare ($64.5 billion) and partly out of surplus budgetary revenues ($45.5 billion).

Although it is difficult to precisely predict all the potential impacts of this Medicare prescription drug proposal, several types of affects can be inferred from previous research. Some studies have shown that drugs can be used as effective substitutes for other kinds of treatment.[1] For example, proper use of medication can be expected to decrease hospital and nursing home costs.[2] According to the General Accounting Office, Medicaid's automated drug utilization system reduced adverse drug reactions and saved more than $30 million in five states.

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1 See for example, the Employee Benefit Research Institute.

2 See *New England Journal of Medicine*, March 4, 1999.

Adding a prescription drug benefit to Medicare might be expected to increase prescription drug usage but not necessarily raise overall medical costs. Financial incentives to drug manufacturers to continue searching for new medicines which might substitute for expensive existing drugs and for in-patient care will continue. In the end, a prescription drug benefit might result in healthier seniors, and curb, or even bring down, overall medical costs.

PROSPECTS FOR THE FUTURE

Recent data confirm that the US economy remains sound and there are virtually no indications for a significant slowdown in the near future. In fact, the lack of an economic slowdown has led some economists to suggest that the traditional business cycle of recessions and recoveries may be obsolete. It may be premature to come to that conclusion, but the economy's performance over the last several years — in particular the long period of non-inflationary low unemployment — clearly suggests that something new is happening to the US economy.

There are several factors which are key to the future prospects of the US economy:

Productivity is the key nutrient to economic prosperity. The more efficient the economy and our workers are, the more we can afford to enjoy higher living standards. It is also important that productivity not come at the expense of employment. Thus, our objective should be to achieve robust productivity and economic growth simultaneously. Economic growth will help re-employ those workers who might have lost their jobs due to productivity gains. Increased **investment**, both public and private, is necessary in order to achieve the dual goals of raising productivity and overall economic growth.

Between 1950 and 1970 productivity grew by 3 and 4 percent annually. This high rate of productivity growth enabled workers to enjoy considerable increases in their living standard. Since then, productivity growth has been on average between 1 and 2 percent annually. In response, workers wages have been stagnant or rising only by a small amount. Since 1995, productivity growth has increased by more than 2 percent annually.

Many analysts link recent increases in productivity with the introduction of new technology, particularly in the information sector. It is too early to confirm or deny this assessment, but if technology is driving increases in productivity, the future could hold sustained increases in productivity as continued investment, research and development yield new products and more efficient practices.

The recent improvement in fiscal policy — moving from continued deficits to surpluses — has resulted in lower interest rates, which in turn has stimulated private investment. Increased productivity-enhancing investment is the cornerstone to achieving non-inflationary economic growth.

The key to future improvements in productivity and investment is the ability to maintain favorable conditions for private investment. These favorable conditions include avoiding a return to the government budget deficits of the 1980s and unnecessary moves to raise interest rates.

There are virtually no sighs of a resurgence of **inflation** in the economy. Increased global competition, falling commodity prices and weak currencies overseas — due to slow growth and the recent financial crisis — are helping keep prices down in the United States. The fact that low and falling unemployment has been coupled with only modest increases in wages has also served as another major factor behind low inflation in the United States. Low interest rates and significant declines in other costs of doing business have also contributed to keeping inflation low. These factors are expected to remain in place for at least the near future.

Employment — The US economy is considered to be a "jobs machine" -- having created, on net, some 20 million jobs since 1992.

Many of these jobs are in sectors which have traditionally paid higher wages that in other sectors. On the other hand, many of these new jobs do not provide health care insurance coverage and pensions.

Unemployment is at its lowest rate in more than 30 years. The gradual nature of this improvement combined with moderate economic growth could keep unemployment rates low into the future. The fact that the unemployment rate has been so low for so long has provided previously low-skilled workers the opportunity to gain valuable experience that assists them throughout their working lives. The drop in unemployment has included hard hit areas and historically higher-unemployed populations including minorities, the less educated and youth. The longer this economic expansion continues, the greater the prospects for meaningful inroads into skill development and income growth for these historically disadvantaged populations.

There are three important concerns in the current economy — the falling and recently negative **saving rate**, the growing **trade deficit** and the growing **income gap** between the wealthy and the rest of society.

Americans have traditional been low savers in comparison to those living in other countries. On the other hand, more Americans own their homes than others abroad. The concern is that since the mid 1970s, the US saving rate has been falling, and this year has gone negative. In other words, on a monthly basis, Americans spend more than they earn, after taxes. Private household saving an important ingredient for domestic investment. Without a healthy home-grown pool of capital, people must borrow from overseas the capital they need to build plant and equipment, carry out research and development, and create good paying jobs. Insufficient domestic saving could lead to less investment or higher interest rates.

America’s need to borrow capital from abroad has contributed to a growing deficit in merchandise trade. US exports have been hurt due to slow growth in Europe and Japan, and the financial crisis in East Asia. In addition, strong growth at home and weak currencies abroad have push up US imports. Over the first half of this year, US imports have been running at 1½ times US exports. Insufficient exports to pay for our imports further contributes to the need to borrow from abroad.

During the 1980s, the United States was borrowing from abroad to finance its ballooning budget deficits. During the 1990s, the United States has been borrowing from abroad to finance its investment boom, since domestic saving was insufficient. Stimulating more domestic saving should thus help reduce some of the need to borrow from abroad.

In addition, the United States has a strong interest in rejuvenating economic growth around the world, particularly in those countries which tend to buy US goods and services. Economic stimulus and financial stability are key to achieving this objective. The United States must also make sure that its currency does not overvaluate, as it did in the 1980s. Maintaining exchange rate stability is also important objective.

The trade deficit has noting to do with the *level* of employment in the United States. For example, unemployment has been falling to historic low levels during the same time that the trade deficit has been rising to record highs. On the other hand, the trade deficit reflects the *composition* of employment, i.e. the pressure on the agriculture sector of the move out of manufacturing employment and into services. In some cases, this compositional change has reflected a move from high wage jobs with benefits to lower wage jobs without benefits.

This shift, together with changes in technology and the lack of skills in the workforce, has contributed to making it harder for most American workers to "get ahead." On the other hand, the tremendous gains in the stock market and other financial markets over the decade have helped upper income people increase their wealth rather substantially. The combination of both factors has resulted in a growing income gap between the small share of wealthy people and the majority of working people in this country. This growing income gap has important economic, political and social consequences which should not be denied or ignored.

One immediate way to address the growing income gap is to strengthen the safety net for those who might not be enjoying the benefits of the current economic expansion. For example, despite a recent increase, the minimum wage, after inflation, remains significantly *below* its level in the 1950s and 1960s. In addition to making up for recent declines in the minimum wage, it is important to remember that any further increases have to be protected from inflation which further erodes the real value of the minimum wage.

Improving access to health care insurance and pensions would also help the majority of Americans reduce their out-of-pocket expenses. Stemming any further widening in the income gap, let alone reducing it, does not have to mean taking wealth away from the rich. It could be done by devoting more of the recent economic gains to those people who's incomes have not been growing as much.

The United States is experiencing an unprecedented period of economic prosperity. Unemployment is at a historic low and there is no sign of a resurgence of inflation. After decades of budget deficits, the government is currently operating in surplus and the Administration is forecasting continued surpluses well into the future. Interest rates are low and investment in booming. Economic developments in the United States since 1992 are the envy of the world.

As good as this story is, it is not complete. Economic prosperity has not yet come to everyone in our society, and for most it has come following a period of prolonged economic hardship. The challenge before the nation is to both ensure the continuation of this economic prosperity and to aim at sharing its benefits more widely with all Americans.

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